

## Chapter 16

# Scope of the Alternative Investment Fund Managers Regime

## 16.3 Managing an AIF

### **G** Question 3.1: What does managing an AIF mean?

A *person* manages an *AIF* when the *person* performs:

- (1) risk management; or
- (2) portfolio management;

for the *AIF*.

### **Question 3.2: If a person performs only one of the activities listed in the answer to Question 3.1 does it manage an AIF?**

Yes. However, an *AIFM* is not permitted to be authorised to manage an *AIF* on that basis (see ■ FUND 1.4.4 R (4)). An undertaking that is seeking *permission to manage an AIF* will not be given *permission* to provide portfolio management without also providing risk management or vice versa.

### **Question 3.3: Are the activities mentioned in the answer to Question 3.1 the only activities included in managing an AIF?**

No. If a *person* manages an *AIF* (within the meaning set out in the answer to Question 3.1), and also carries on:

- (1) one or more of the additional activities listed in the answer to Question 3.4); or
- (2) one or more other activities in connection with or for the purposes of the management of that *AIF*;

those activities are included in the *regulated activity of managing an AIF*.

### **Question 3.4: What are the additional activities referred to paragraph (1) of the answer to Question 3.3?**

They are as follows:

- (1) administration:
  - (a) legal and fund management accounting services;
  - (b) *customer* inquiries;
  - (c) valuation and pricing (including tax returns);
  - (d) regulatory compliance monitoring;

- (e) maintenance of *unit / share* holder register;
- (f) distribution of income;
- (g) *unit* issues and redemptions;
- (h) contract settlements (including certificate dispatch) and;
- (i) record keeping;
- (2) *marketing*; and
- (3) activities related to the assets of *AIFs*, namely:
  - (a) services necessary to meet the fiduciary duties of the *AIFM*;
  - (b) facilities management;
  - (c) real estate administration activities;
  - (d) advice to *undertakings* on capital structure, industrial strategy and related matters;
  - (e) advice and services related to mergers and the purchase of *undertakings*; and
  - (f) other services connected to the management of the *AIF* and the companies and other assets in which it has invested.

**Question 3.5: Does anyone carrying on only the activities listed in the answer to Question 3.4 carry on the regulated activity of managing an AIF?**

No. Those activities only involve *managing an AIF* for a particular *AIF* if the *person* doing them is carrying on, for that *AIF*, the part of the *regulated activity of managing an AIF* described in the answer to Question 3.1. If an *AIFM* carries on the activities listed in the answer to Question 3.4 in relation to a fund of which it is the *AIFM* those activities are included in the *regulated activity of managing an AIF*. But, if the activities listed in the answer to Question 3.4 are carried on by a third party, that third party will not be carrying on the *regulated activity of managing an AIF* for that *AIF*, although that third party may be carrying on other *regulated activities*, such as *arranging (bringing about) deals in investments* or *making arrangements with a view to transactions in investments*.

**Question 3.6: Can an AIF manage itself?**

Yes. An *AIFM* may be:

- (1) another *person* appointed by or on behalf of the *AIF* and which through that appointment is responsible for managing the *AIF* (an external *AIFM*); or
- (2) where the legal form of the *AIF* permits internal management and where the *AIF's governing body* chooses not to appoint an external *AIFM*, the *AIF* itself (an internal *AIFM*).

**Question 3.7: What effect does delegation have?**

An *AIFM* is permitted to appoint a delegate to provide portfolio management and/or risk management services for the *AIFM* (see ■ FUND 3.10 and regulation 26 of the *AIFMD UK Regulation*).

If the delegation relates to the additional services described in the answer to Question 3.4 (What are the additional activities referred to paragraph (1) of the answer to Question 3.3?) the delegate will not be *managing an AIF*, for

the reason in the answer to Question 3.5 (Does anyone carrying on only the activities listed in the answer to Question 3.4 carry on the regulated activity of managing an AIF?).

In any case, under article 51ZC(3) of the RAO a *person* does not *manage an AIF* if the functions it performs for the *AIF* have been delegated to it by another *person*, provided that such other *person* is not an *AIFM* that has delegated such functions to the extent that it is a letter-box entity. So a *person* who has received a delegation of some of the *AIFM*'s core functions (ie, the functions listed in the answer to Question 3.1 (What does managing an AIF mean?)) generally does not *manage an AIF*. Letter box entities are described in the answer to Question 3.8 (Does this mean that delegation can never affect who is doing the regulated activity of managing an AIF?).

This answer reflects the *AIFMD* regime in the *United Kingdom*, which envisages that generally an *AIFM* may delegate functions without the delegate becoming the *AIFM* in place of the original manager, or the delegate becoming the *AIFM* alongside the original manager, in breach of the requirement that there be only one *AIFM*.

**Question 3.8: Does this mean that delegation can never affect who is doing the regulated activity of managing an AIF?**

Delegation can sometimes affect who is *managing an AIF*.

Article 82 of the *AIFMD level 2 regulation* says that an *AIFM* shall be deemed a letter-box entity and shall no longer be considered to be the manager of the *AIF* at least in any of the situations set out in that article, which is reproduced in ■ FUND 3.10.9 EU.

This raises four questions. First, whether an *AIFM* that delegates in such a way as to make itself into a letter-box entity is still carrying on the *regulated activity of managing an AIF*. This is dealt with in Question 3.9. Secondly, whether the delegate is carrying on the *regulated activity of managing an AIF*. This is dealt with in Question 3.10. The third question is whether this only applies when the *UK* provisions which implemented article 20 of *AIFMD* (which contains the letter-box entity provisions elaborated by article 82) applies. This is dealt with by Question 3.12. The fourth question is what the test for a letter-box entity is. This is dealt with in Question 3.13.

**Question 3.9: Does delegation by the manager mean that it is no longer carrying on the regulated activity of managing an AIF?**

The fact that article 82 of the *AIFMD level 2 regulation* says that a letter-box entity shall no longer be considered to be the manager of the *AIF* would appear to mean that an *AIFM* that delegates in this way is no longer *managing an AIF*. However, in our view, an *AIFM* that delegates in such a way as to make itself into a letter-box entity is still carrying on the *regulated activity of managing an AIF*. The following points support this:

- (1) Article 82 of the *AIFMD level 2 regulation* describes who is acting as the manager. The *regulated activity* does not refer to acting as an *AIFM*; it simply refers to managing an *AIF*. The *regulated activity* does not expressly incorporate article 82 as part of the definition.
- (2) The RAO does not include the requirement in the *AIFM* definition that the *AIFM* be a legal *person*, which shows that the definition of *AIFM* is not fully aligned with the definition of *managing an AIF*.

(3) Regulation 4(3) of the *AIFMD UK Regulation* envisages that the *AIFM* will be appointed by or on behalf of the *AIF* or by its *governing body*. This is not reflected in the RAO either.

(4) The UK provisions which implemented article 20 of *AIFMD* (which contains the letter-box entity provisions elaborated by article 82) deal with regulating how an *AIFM* should manage its AIF.

(5) There is a good reason why an *AIFM* that has delegated its functions in a way that means it has become a letter-box entity should still be carrying on the *regulated activity of managing an AIF*. It is necessary to avoid the risk that a manager that delegates to this degree falls out of regulation, because it stops carrying on a *regulated activity*. One of the purposes of regulation is to stop a manager doing this and effective implementation of *AIFMD* requires us to be able to do so.

**Question 3.10: Does delegation by the manager mean that the delegate is carrying on the regulated activity of managing an AIF?**

The factors listed in the answer to Question 3.9 (Does delegation by the manager mean that it is no longer carrying on the regulated activity of managing an AIF?) support the view that a delegate of a letter-box entity does not *manage an AIF*. However, despite this, we believe that a delegation by the *AIFM* to a delegate can result in the delegate *managing an AIF* if the delegation results in the *AIFM* becoming a letter-box entity.

(1) Recital (9) of *AIFMD* confirms that the letter-box entity provision is an anti-avoidance provision preventing circumvention of the UK provisions which implemented *AIFMD* by means of turning the *AIFM* into a letter-box entity. A provision of this kind reflects a more general principle that rights originally given by the UK provisions which implemented European law (such as the right of a manager to delegate or the right of a delegate to carry on its business without being authorised as an *AIFM*) should not be abused. It is important to know who the real manager of an *AIF* is, so as to know whether an *overseas regulator* is responsible for its supervision or whether the *AIF* is managed from outside the *United Kingdom*. If the real manager is not *managing an AIF*, it may not be carrying on any *regulated activity* and may not fall under any financial services regulation, even though effective implementation of *AIFMD* would have required the situation to be regularised.

(2) Article 51ZC(3) of the RAO implies that a *person* that has accepted a delegation from a manager that results in the manager becoming a letter-box entity, can be *managing an AIF*.

(3) It is not unreasonable to say that, if the delegate is in practice carrying out the management activities described in the answer to Question 3.1 (What does managing an AIF mean?), it should be treated as carrying on the *regulated activity*.

**Question 3.11: Does this mean that delegation that results in the manager being a letter-box entity always means that the delegate will be carrying on the regulated activity of managing an AIF?**

No. In each case it is necessary to apply the tests set out in ■ PERG 16.3. If all the functions that have been delegated by the letter-box entity manager have been delegated to the same delegate, it is likely that that delegate is *managing an AIF*. However, if the delegation is to a number of delegates, it may be that none of those delegates is *managing an AIF*.

**Question 3.12: Do the answers to Questions 3.7 to 3.11 apply just to delegation by a full-scope UK AIFM?**

No. For example, they would be relevant to whether a delegate in the *UK* is *managing an AIF* if it accepts a delegation from an overseas manager. We take this approach for the following reasons.

(1) The arguments in Question 3.10 (Does delegation by the manager mean that the delegate is carrying on the regulated activity of managing an AIF?) are also in favour of the view that the effect of delegation on a delegate should not be confined to delegation by an authorised *AIFM*. In any case, it would be anomalous for delegation to affect who is *managing an AIF* only when the UK provisions which implemented article 20 of *AIFMD* apply, particularly given that article 82 is, in our view, an anti-avoidance provision (see the answer to Question 3.10).

(2) Article 51ZC(3) of the RAO is not specifically limited to circumstances in which article 20 applies. It applies in any situation in which it is necessary to decide whether a *person* is *managing an AIF* for the purpose of the *general prohibition*.

**Question 3.13: What is the test for a letter-box entity?**

In our view, the test of whether delegation results in the delegate *managing an AIF* is decided by article 82 of the *AIFMD level 2 regulation* in circumstances when article 82 and the *UK* provisions which implemented article 20 of *AIFMD* apply to the delegating *AIFM*.

When the *UK* provisions which implemented article 20 do not apply we look at whether the delegation is to such a degree that the manager can no longer be considered to be carrying out the activities in the answer to Question 3.1 (What does managing an AIF mean?). We take the various factors elaborated in article 82 into account but they will not necessarily decide the matter because article 82 is, on its face, linked to article 20 and article 51ZC(3) of the RAO does not specifically refer to article 20 or 82.

If a manager to which article 82 does not apply can nevertheless satisfy all the conditions set out in that article to demonstrate that it has not become a letter-box entity, any delegation by it will not result in the delegate *managing an AIF*.

However, we do not necessarily require that delegate to demonstrate to us that every condition of article 82 is satisfied, to conclude that the manager is not a letter-box entity and that the delegate is not *managing an AIF*. The importance of the tasks carried out by the manager is a key consideration, taking particular account of the right and ability of the manager to exercise oversight and control and the degree to which these rights are exercised. In our view, these factors reflect the fact that we are applying a broad anti-avoidance approach to a letter-box entity rather than the detailed requirements of article 82.

**Question 3.14: Is the material in PERG 16.3 about delegation relevant to delegation between branches of the same firm?**

No. Please see Question 8.4 (Is the material in PERG 16.3 about delegation of management functions from one firm to another relevant to delegation from one branch to another?).

**Question 3.15: If a person is not eligible to be appointed as an AIFM because it is not a legal person but is appointed to manage an AIF, does that mean that it cannot carry on the regulated activity of managing an AIF?**

No. The fact that it is not eligible to be appointed as an *AIFM* does not mean that it is not *managing an AIF*. That means that an *unauthorised person* may breach the *general prohibition* by carrying on the *regulated activity of managing an AIF*, even though the *person* does not qualify for a *Part 4A permission* because that *person* is not a legal person.

Article 6(1) of *AIFMD* provides that no *AIFMs* should manage *AIFs* unless they are authorised in accordance with that Directive. An *AIFM* must be a legal person. So it appears that the *regulated activity of managing an AIF* cannot apply to someone who is not a legal person. However, in our view, this is not the case. As explained in the answer to Question 3.9 (Does delegation by the manager mean that it is no longer carrying on the regulated activity of managing an AIF?), the definition of an *AIFM* is not fully aligned with the definition of *managing an AIF*. In particular, the *regulated activity* does not refer to acting as an *AIFM* (the definition of *AIFM* in the *AIFMD UK Regulation* includes the legal person requirement), it simply refers to managing an *AIF*. There is a good policy reason for this. It is not the intention of the legislation to allow someone who is not a legal person to manage an *AIF* without being authorised, but to stop an *AIF* being managed by someone who is not a legal person.

**Question 3.16: Can an AIF in the form of a limited partnership under the Limited Partnerships Act 1907 appoint its general partner as the AIFM?**

Yes. If the general partner is the *AIFM* it will be an external *AIFM*.

Strictly speaking this question is not relevant to the definition of *managing an AIF* but this is a convenient place to discuss the point.

On the face of it the answer should be No. The starting position is that if an *AIF* is managed by the body that has responsibility for governing it under the legislation under which the *AIF* is formed, the *AIF* is internally managed, particularly if there is no *governing body* that appoints and supervises the manager and the manager is a member of that *AIF*. A general partner is a partner and there will usually be no *governing body* separate from the general partner. Under this approach, a limited partnership would be internally managed, which would be contrary to the *AIFMD* regime in the *United Kingdom*, as an *AIFM* must be a legal person and an English and Welsh limited partnership is not a legal person.

However, in our view, the roles of the limited and general partners are sufficiently distinct for one to be able to say that the limited partnership does not manage itself. The distinction between the two roles does not stem from the fact that the general partner manages the partnership, but from the facts that:

- (1) the roles of general and limited partner are provided for by the legislation under which limited partnerships are formed; and
- (2) the legislation, in practice, prevents the limited partners from managing the partnership (because for as long as a limited partner takes part in the management of the partnership business, it is liable for the partnership's debts as though it were a general partner).



In principle, the same should apply for jurisdictions outside England and Wales with legislation drafted in the same way. We understand that this is the case with a Scottish limited partnership (which has legal personality) and so if its general partner is appointed as its *AIFM* it will also be an external *AIFM*.